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SUBJECT: MACEDONIAN GOVERNMENT AND GREEK OIL COMPANY SIGN SETTLEMENT AGREEMENT

Summary

¶1. (SBU) The GOM signed a settlement with Hellenic Petroleum on December 31, 2007 to pay 40 million dollars in penalties for Macedonia's past violations of the 1999 privatization agreement of the OKTA oil refinery, which is owned and operated by Hellenic Petroleum. The agreement also extended the deadline for OKTA to meet more stringent environmental standards. The settlement reached between the GOM and a large Greek investor, which is partially owned by the Greek government, demonstrated that commercial matters can move forward despite political disagreement between Greece and Macedonia over the name issue. End summary.

A Bad Deal Violated

¶2. (SBU) In 1999, under then Prime Minister Ljupco Georgievski's VMRO government, Macedonia sold the state-owned OKTA refinery to Hellenic Petroleum for $32 million dollars. The privatization process was non-transparent and widely viewed in Macedonia at the time as a corrupt transaction. The terms of the twenty-year agreement were also criticized as unfavorable to the GOM, including obligations that the GOM purchase from OKTA 500,000 tons of heavy fuel oil annually or pay a $27 per ton penalty, and that the GOM ensure a minimum of one million tons of oil flow through the Skopje-Thessaloniki pipeline annually. The GOM also gave OKTA the exclusive right to import oil, with a duty of only one percent. Current Prime Minister Nikola Gruevski was Minister of Trade at the time the arrangement was concluded, but claims that he was not involved in the negotiation or approval of the deal.

¶3. (U) The GOM, under previous and current governments, subsequently violated the terms of the privatization agreement. It consistently failed to purchase the minimum 500,000 tons of heavy fuel oil or guarantee the one million ton throughput for the pipeline. The GOM also allowed other companies to import petroleum products, violating the agreement's exclusivity clause. In 2004, OKTA filed suit in the International Chamber of Commerce's International Court of Arbitration. In August 2007, the arbitration court ruled in OKTA's favor, awarding it $53 million in damages.

Environmental Regulations As Bargaining Tool?

¶4. (SBU) The GOM appears to have used fuel environmental standards in an attempt to gain leverage in the negotiations. In July 2007 the parliament approved new fuel standards for unleaded and diesel fuels. Then, in September 2007, following the August arbitration court ruling, the parliament

revised the law to significantly shorten the deadline for implementing the new fuel standards. OKTA officials told Econoff in early December that it would be impossible to upgrade the refinery in time to meet the new deadlines for implementing the tougher standards.

A Settlement Both Sides Could Live With

¶5. (SBU) On December 31, 2007, the GOM and Hellenic Petroleum signed a settlement agreement that included the following provisions: the GOM would pay $40 million in damages for past violations through 2007, OKTA would transfer 20 percent of the ownership of the Skopje-Thessaloniki pipeline to the GOM (as agreed to in the 1999 agreement), and the GOM would extend the deadline for OKTA to meet the higher fuel quality standards. The settlement agreement addresses only past, but not any future, violations of the 1999 purchase agreement. The agreement includes a specific provision that "immediately after closing" of the settlement agreement the sides will appoint representatives to negotiate "the modalities for avoiding" future violations of the purchase agreement. Opposition members criticized the GOM for not resolving these future obligations before paying the damages, thereby weakening its bargaining position on the remaining issues. In the future the GOM is unlikely to meet the targets of purchasing 500,000 tons of heavy fuel oil or the one million ton throughput for the pipeline, while it would be politically and economically costly to forbid other companies from importing oil.

¶6. (SBU) Aristides Vlachos, the president of the Macedonian International Council of Investors, (primarily an association of Greek companies in Macedonia), told Econoff that the settlement agreement was carefully constructed so that both sides could claim victory. The GOM's spokesperson claimed

that Macedonia would have had to pay $94 million if it had paid the full damages with interest for all past violations of the agreement, so he claimed the GOM had saved tax payers $54 million by agreeing to the $40 million figure. Hellenic Petroleum was able to tell its shareholders, including the Greek government which owns approximately a third of the company's shares, that it had recouped 80 percent of the damages awarded by the arbitration court and also changed the unrealistically short deadline for new fuel standards.

Comment: GOM-Greeks Continue To Do Business

¶7. (SBU) The settlement agreement demonstrated two important points: first, that the GOM was committed to paying damages for its past contractual violations, no matter how flawed the original agreement, and second, that the GOM and an important Greek investor were able to reach a mutually satisfactory agreement regardless of the political strains surrounding the Greek government's threat to veto Macedonia's NATO invitation if Skopje does not agree to resolve the name issue before then. The GOM has the cash to pay OKTA the $40 million settlement, thanks to better-than-projected tax collection in ¶2007. Now, however, the GOM will face difficult negotiations to resolve its obligations under the remaining 11 years of the original contract.
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